profit on a service unless it is able to recover all of the costs that it will actually incur at a given point in time. Finally, Section 252(d)(2) states that the reciprocal compensation for transport and termination of traffic under Section 251(b)(5) shall not be considered just and reasonable unless it at least covers the "additional costs" of terminating calls from the other carrier's network.[85] This guarantees that the incumbent LEC and the CLEC will not recover less than the costs that are caused by the traffic that they receive from each other.[86]

Taken together, these provisions guarantee that the carriers who provide interconnection will be allowed a reasonable opportunity to recover their total costs. Total costs include the following:

- Investment-related costs (debt and equity costs of capital, taxes, and depreciation);
- Direct costs (direct maintenance, direct administration, and other costs that can be directly identified with demand for a service); and

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Dictionary, 1985, p. 939. Traditionally, the Commission has incorporated a "cost of capital" in the LECs' regulated rates to recover investment-related costs, based on the returns on debt and equity necessary for the LECs to attract capital. By using the word "profit," Congress may have intended to include an additional return on equity to recognize the increased risk factor that investors will apply to the LECs due to increased competition in the local exchange. In these Comments NYNEX proposes to include only its current costs of capital in the pricing of interconnection and network elements under Section 251.

[85] Section 252(d)(2)(B) provides that the parties to a reciprocal compensation agreement may waive mutual recovery through arrangements such as Bill-and-Keep. However, the statute does not provide that such arrangements can be imposed on a LEC or a CLEC. This preserves the carriers' ability to decide whether Bill-and-Keep would, through the "offsetting of reciprocal obligations," provide a reasonable opportunity for the carriers to recover their costs.

[86] As is discussed below, this is the only provision of Sections 251 or 252 that could be interpreted as incorporating an incremental costing standard. The fact that Congress adopted a different standard -- cost plus a reasonable profit -- for interconnection and unbundled network elements demonstrates that it intended to include more than just incremental costs in the latter categories.

- Indirect costs (joint and common costs such as general administrative, human resources, research and development).

Rates for interconnection and network elements that do not allow an incumbent LEC to recover these costs would be confiscatory.[87] They would also deter potential entrants in the local exchange market from constructing their own facilities, since new entrants would incur greater costs by building facilities than by purchasing them from the incumbent LECs. Therefore, the Commission should adopt rules for the pricing of interconnection under Section 251 of the Act which would give the incumbent LECs a reasonable opportunity to recover all of their costs.

This approach is also fully consistent with the federal antitrust laws. It is worth noting that, under the antitrust laws, a market participant has no general duty to aid a competitor.[88] Even in the very limited, specific circumstance where a monopolist may be required to provide a potential entrant with access to some "essential facility," the entrant is nonetheless responsible for bearing the costs associated with such entry. Any other result would mean not only that the incumbent firm must guarantee access, but also that it must subsidize that access. The antitrust laws compel no such perverse result.

Thus, for example, it has been held that a firm with monopoly power is not required to modify its facilities or incur significant costs for the benefit of competitors or others

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87 See Duquesne Light Co. v. Barasch, 488 U.S. 299, 308-310 (1989) ("If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments"); Penn Central Transp. Co. v. New York City, 438 U.S. 104, 124 (1978); Bell Atlantic Telephone Companies v. F.C.C., 24 F. 3d 1441, 1445 (D.C. Cir. 1994).

88 Olympia Equipment Leasing Co. v. Western Union Telegraph Co., 797 F.2d 370, 375 (7th Cir. 1986), cert. denied, 480 U.S. 934 (1987)

where to do so would be uneconomical.[89] In the words of the Seventh Circuit, a company has "no right under antitrust law to take a free ride" on its competitor, "even if the competitor has monopoly power and [the company is] a struggling new entrant."[90] Certainly, NYNEX has every justification from an antitrust perspective to ask potential entrants to share fully in the costs of providing them network access.

This conclusion also necessarily follows from the emphasis expressly stated in the NPRM that the purpose of the Act "is not to ensure that entry shall take place irrespective of costs, but to remove both the statutory and regulatory barriers and economic impediments that inefficiently retard entry, and to allow entry to take place where it can occur efficiently. This entry policy is competitively neutral: it is pro-competition, not pro-competitor."[91]

By limiting application of the Act to "efficient" entry, the NPRM accurately recognizes the lack of any Congressional intent to require subsidization by incumbent LECs of entrants.[92] Subsidization, which inevitably occurs in the scenario where less than total cost is recovered, encourages the exact opposite result: inefficient entry. Furthermore, a regulatory approach which permits a competitor to enter with the artificial boost of an incumbent's direct subsidization through less than total cost recovery, promotes a pro-competitor (versus a pro-competition) policy -- an interpretation expressly acknowledge by the NPRM to be inconsistent

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89 See Oahu Gas Service, Inc. v. Pacific Resources, Inc., 838 F.2d 360, 368-69 (9th Cir.), cert. denied, 488 U.S. 870 (1988); General Motors Corp., 99 F.T.C. 464 (1982).

90 Olympia Equipment Leasing, 797 F.2d at 377-78.

91 NPRM, ¶ 12.

92 See also NPRM ¶¶ 76, 135. As noted above, the same result also follows from the express provision in Section 252(d)(1) that a "just and reasonable" rate contemplates "a reasonable profit."

with the Act.[93] On the other hand, by implementing regulations that contemplate total cost recovery, the Commission ensures compliance with the intent of the legislation in that only efficient entry is encouraged.

C. The Commission Should Not Establish Cost Standards For Interconnection And Network Elements That Would Prevent The LECs From Recovering Their Actual Costs

In the NPRM, the Commission asks for comments on its tentative conclusion that the pricing principles for interconnection and network elements in Section 251(d)(1) may contemplate a "forward-looking cost methodology that does not involve the use of an embedded rate base, such as long-run incremental cost ("LRIC")."[94] NYNEX disagrees with this statement for three reasons. First, there is nothing in Section 251(d)(1), or in any other part of the Act, that demonstrates any Congressional intent to require the LECs to write off their embedded investment base.[95] Second, the term "cost" under Section 251(d)(1) for interconnection and network elements includes the LECs' cost of capital; profit may include an additional amount above the cost of capital that the Commission has traditionally included in the LECs' regulated rates to recognize the greater degree of risk that they will face in the future.[96] Neither term can

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93 NPRM, ¶ 12.

94 NPRM at ¶ 123.

95 Nor is there any evidence that the current investment base is not "used and useful" by the LECs in providing telephone service, such that the LECs can legally be denied the opportunity to earn a return on that investment.

96 "Profit" is an accounting term that includes the excess of revenues over all costs, including book costs and "economic" costs (such as LRIC). By stating that interconnection rates "shall" be based on cost and "may" include a reasonable profit, Congress clearly intended to permit the LECs to recover, at a minimum, their full costs including the cost of capital. While Congress may have intended to permit an additional profit above the cost of capital,

be interpreted to exclude the cost of capital associated with the embedded investment that a LEC uses in providing interconnection or network elements.[97] Third, the LECs will not generally use incremental investment to provide unbundled network elements. They will generally provide in-place facilities to interconnectors. In this regard, the proposals of some parties to set interconnection rates based on the "total service long run incremental cost" ("TSLRIC") methodology,[98] which they have defined using hypothetical investment levels as if the network were built from scratch, are inconsistent with both LRIC economic costing principles and the statutory guarantee that a LEC will be able to recover its actual costs.[99]

The Commission bases its tentative conclusion that it may exclude the incumbent LECs' embedded investment costs from their interconnection rates on the statement in Section 251(d)(1) that just and reasonable rates shall be "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding)." This is an extraordinarily weak basis for requiring incumbent LECs to write off potentially billions of dollars of existing costs. Not only is there no legislative history to suggest that Congress intended to force incumbent LECs to suffer economic loss as a result of providing unbundled elements and interconnection, the Commission's conclusion does not even square with the plain language of the Act. Section 251(d)(1) clearly prohibits use of a traditional rate of return proceeding to determine just and

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NYNEX does not propose to include such a "risk premium" in the pricing of interconnection and network elements.

97 A LEC's cost of capital includes a return on its existing investment to holders of debt and equity that the LEC issued to acquire that investment.

98 See NPRM at ¶¶ 124-26.

99 Properly defined, TSLRIC includes the forward-looking costs that vary with an entire service, using a carrier's existing network.

reasonable rates for interconnection. This is in line with the statutory scheme of relying upon inter-carrier negotiation, and regulatory arbitration, to set rates. It does not say anything about the types of investment costs that should be recognized by State or Federal regulators in judging the reasonableness of interconnection rates. In addition, the only pricing standard in the Act that could reasonably be interpreted to incorporate incremental costing principles is Section 252(d)(2)(A)(ii), which states that rates for reciprocal compensation under Section 251(b)(5) shall at least recover the "additional cost" to LECs and CLECs of terminating each other's traffic. The fact that Congress used a different standard -- cost plus a reasonable profit -- for interconnection and unbundled network elements shows that Congress did not intend to apply incremental pricing to these types of interconnection.[100]

If the Commission wants to use LRIC pricing principles to establish guidelines for negotiating rates for interconnection and network elements, it must be able to show, in the first instance, that those principles would produce "just and reasonable" rates as specified in Section 251 of the Act. Any pricing methodology that does not permit the LECs to recover the costs that they will incur at a given point in time to provide interconnection would be contrary to the Act. In addition, the Commission must reconcile LRIC pricing with the statutory standard of "cost" plus "a reasonable profit."

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[100] It should also be noted that Congress did not apply either the "cost plus a reasonable profit" or "additional cost" standard to rates for collocation under Section 251(c)(6). This suggests that Congress intended for the Commission to apply more traditional ratemaking principles to collocation, which is only subject to the standard that collocation rates be "just, reasonable, and non-discriminatory."

As the Commission notes, any discussion of incremental costing must begin with a definition of the terms being used.[101] In these comments, NYNEX defines its terms as follows:

Long Run Incremental Costs (LRIC) -- the forward-looking changes in costs that are caused by the next increment of output[102]

Short Run Incremental Costs (SRIC) -- the changes in costs that are caused by the next increment of output over the short term, where some resources are taken to be fixed

Direct Costs -- costs, including investment, maintenance, and administration, that are directly identified with a particular service

Joint Costs -- costs that are incurred for a group of services in fixed proportions

Common Costs (also referred to as Overhead Costs) -- costs that are incurred to provide all services, such that the costs do not vary with changes in the quantity of any particular service

Forward-Looking Costs -- investment-related costs that would be incurred in the future to provide a service

Embedded Costs -- investment-related costs previously incurred to provide a service or group of services

Total Service Long Run Incremental Costs (TSLRIC) -- forward-looking incremental costs which reflect all changes in costs caused by the entire service demand.

Fully Distributed Costs (FDC) – costs for jurisdictionally separated interstate services as determined by the Part 32 Accounting, Part 36 Separations, and Part 69 Access charge rules.

Accounting Costs -- costs actually incurred by the firm at a given point in time and recorded in its books, including direct costs, joint costs, and common costs

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[101] See NPRM at ¶126.

[102] See A. Kahn, Economics of Regulation, 1970, p. 66.

Incremental costing methodologies do not necessarily exclude joint or common costs. However, for a multi-product firm (like a LEC), it is difficult to assign joint and common costs to a particular product, despite the fact that the firm must incur such costs in order to produce that product. For this reason, regulatory commissions and carriers typically exclude most joint and common costs from LRIC studies, and they add these costs to LRIC using some type of allocation factor in developing rates.[103]

Even with an allocation of joint and common costs, LRIC pricing would prevent a LEC from recovering its total costs.[104] This is due to two factors. First, for firms, such as the LECs, that are subject to economies of scale, the LRIC cost of the next increment of output will be less than the average unit cost of the firm's existing output. Therefore, if all output were

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[103] See NPRM at paras. 129-30, where the Commission recognizes that it may have to adopt some method of allocating joint and common costs in addition to LRIC in setting rates for interconnection and network elements. In the past, the LECs have sometimes excluded overhead costs in their LRIC methodologies when filing discount tariffs. This is a reasonable methodology because it is based on the assumption that if the LEC did not reduce its rates to large volume customers, they would lose those customers to competing carriers, and they would still have to recover the same amount of overhead costs from their remaining customer base. However, when an incumbent LEC provides interconnection, it cannot assume that it will continue to recover its overheads from its remaining customer base since the interconnection will enable the CLEC to compete for that customer base. Therefore, a LEC must assume that the provision of interconnection will require it to recover its overhead cost, in part, from the CLECs if it is to continue to provide such services.

[104] As recognized by Chairman Hundt, "setting prices for all services at long run incremental cost will not pay for the entire network" because costs are "declining over time" and because "forward looking costs as a pricing principle will not fully compensate for network investments of the past." *See* Speech of Reed Hundt at Northwestern University, May 10, 1996, delivered by FCC Chief Economist Joe Farrell. For this reason, the Chairman believes that " in adhering to the strictures of Section 251 incumbent LECs must, at the very minimum, be permitted to charge for forward looking joint and common costs."

priced at the LRIC of the next increment of output, the LEC would not recover its total costs.[105] Second, the LECs are facing conditions of long-run decreasing costs for network facilities due to the effects of technological advances. This means that the forward-looking investment for providing a service at any point in time will be less than the investment that a LEC has already purchased up to that point. For instance, if a CLEC ordered a DS1 interoffice facility, the LEC's current costs might include a blend of copper and fiber interoffice facilities, while the forward looking costs would probably be all fiber. If a LEC priced all of its services using LRIC, even including all joint and common costs, it would not recover the investment-related costs for embedded investment that it actually used in providing service.[106]

For these reasons, LRIC-based prices, even with an allocation of joint and common costs, would require the LECs to charge prices that would not recover their actual costs of providing interconnection and network elements. This would conflict with the statutory standard of "cost" plus "a reasonable profit." Moreover, if the Commission adopted pricing

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[105] This is particularly relevant if the Commission allows ICs, either directly, or through affiliated CLECs, to purchase unbundled network elements, and if the Commission requires the LECs to combine network elements to allow a purchaser to recreate the LEC's bundled services (which it should not). In that event, the pricing of unbundled network elements could replace existing access charges, and the LECs would recover less than their total costs of providing access and local exchange services.

[106] In an unregulated market, producers facing long run decreasing costs insist on a greater return on capital over the short run because their investment has a short economic life. However, the Commission and the state regulatory authorities did not permit the LECs to use the accelerated depreciation rates that they would have needed to recover their investment over the short-term. The current LEC cost of capital is based on investor perception that regulatory agencies would permit the LECs to earn a return on their embedded investment over its useful life, despite its shorter economic life. If the government required the LECs to write off that investment, the cost of capital would soar, because investors would perceive much higher risks associated with regulated telecommunications services.

guidelines for network elements that ignored actual investment as well as joint and common costs, access customers could use the unbundled rates to evade the resale pricing rules under Section 252(d)(3) of the Act, because the combined network element prices would be far less than the LECs' retail rates minus "avoided cost."[107] In addition, it would discourage facilities-based competition in the local exchange, because it would be very difficult for a new entrant to meet the prices of the incumbent LEC.

If the Commission adopts pricing guidelines for interconnection, it should adopt an accounting cost standard, as described below, which would recognize all of the costs that a LEC would incur in providing interconnection to a CLEC. In addition, to give the LECs and the CLECs room to negotiate mutually satisfactory rates, the Commission should allow the LECs to use LRIC-based rates as a floor, or minimum. Rates that recovered LRIC would not be anticompetitive, as they would include at least the direct costs that a LEC would incur in providing interconnection. Rates above LRIC would help to recover the overhead costs that the LECs incur to provide all services. Using accounting costs as a ceiling would ensure that interconnectors did not pay more than their fair share of overhead costs and embedded costs associated with the facilities and functions that the LECs provided to them.

Pricing on the basis of TSLRIC, as defined by parties such as AT&T and MCI, is fundamentally different than pricing on the basis of LRIC. They have defined TSLRIC as the

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[107] This assumes that the Commission would require the LECs to combine the network elements into a functional equivalent of their retail services. However, as discussed above, that would be bad policy, and it would be inconsistent with Section 251(c)(3) of the Act, which contemplates that the interconnectors would combine LEC network elements with their own facilities to provide telecommunications services

hypothetical costs that a LEC would incur if it built entirely new plant using more modern technologies, and with any other hypothetical cost savings that were built into the model.[108] Defined in this way, TSLRIC does not produce reasonable prices. Under a market economy, the purpose of pricing is to inform purchasers of the additional costs that society will incur if they purchase a particular product, and to give purchasers the ability to choose the most efficient supplier.[109] This process encourages efficiency and reduces the costs to society of meeting consumer demand. If a LEC charged TSLRIC prices, its prices would be identical to those of a more efficient producer that actually built a new network using more modern technologies, and there would be no way for society, through the purchasing decisions of consumers, to distribute business to the most efficient producer. For purposes of incremental costing analysis, the only pertinent costs for a particular carrier are the costs that it will incur given the commitments it has undertaken and the facilities that it has already acquired. This is how competitive markets work, where each competitor must make its own decisions about what kinds of plant will be necessary to meet demand and live with the consequences. TSLRIC ignores this fundamental requirement for a competitive marketplace.

TSLRIC pricing studies that have been presented to the Commission typically produce rates that are more than 50% lower than current rates. This is because they are based on

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[108] See AT&T Letter to Regina Keeney, FCC, March 21, 1996, Attachment at pp. 39-49; AT&T Comments in CC Docket No. 96-45 (April 12, 1996) at p. 14 n. 19; Defining and Funding Basic Universal Service, A Proposal of MCI Communications Corp. (July 1994) at p. 11; see also ALTS Handbook Implementing Local Competition Under the Telecommunications Act of 1996, A Proposed Handbook for the FCC, at pp. 15-16.

[109] See A. Kahn at p. 164.

hypothetical "blank slate" investment assumptions and because they do not include any allocation of joint and common costs. If TSLRIC were used to price to all access charges, the resulting 50% reduction in revenues would eliminate all of the net earnings of most RBOCs. Even if TSLRIC were applied only to interconnection, it would provide no incentive for the LECs to invest in their networks. Moreover, TSLRIC pricing of interconnection would have to be based on the assumption that the LECs would recover their overhead costs and the remainder of their actual costs from their retail customers. However, interconnection is designed to facilitate the ability of CLECs to compete for those retail customers. As the LECs lose market share in the retail market, they lose the ability to recover the common costs that they would still incur even if they were limited to functioning as wholesale carriers. For these reasons, TSLRIC pricing is unsustainable over the long run.

D. The Commission Should Adopt Pricing Rules That Would Permit The Carriers And The States To Determine Just And Reasonable Rate Levels Without Conducting Rate Of Return Proceedings

1. The Commission Should Establish Interconnection Pricing Principles That Are Based On A Carrier's Accounting Costs

To be consistent with the Act, the Commission should establish pricing guidelines that would not require the States or the Commission to conduct "rate-of-return or other rate-based" proceedings. In addition, if the Commission determines that network elements are facilities or functions, and not jurisdictionally distinct services,[110] it would have to develop pricing principles that do not rely on Part 36 cost separations. This can be done with reference to

[110] See NPRM at ¶ 164.

the Part 32 USOA system of accounts, which contains a detailed breakdown of investments and expenses on a total company basis, prior to separations.

The Commission should adopt "accounting costs" as the standard for determining the reasonableness of interconnection rates. This would permit the LEC to charge an interconnector only the costs of the facilities requested, including a reasonable amount of joint and common costs associated with those facilities. Such a costing methodology would not be based on jurisdictionally-separated costs, it would not include the costs of facilities or services other than those requested by the interconnector, and it would not reflect the pricing scheme for access services.

The Commission should establish guidelines that would place the burden on the incumbent LEC to produce Part 32 account data that would be associated with a particular type of interconnection requested under Section 251. For example, if a CLEC requested central office switching as an unbundled network element, the incumbent LEC would have to estimate the investment associated with the switches in question, using either an allocation of Part 32 switching investment accounts or cost studies based on acquisition costs for those switches. The incumbent LEC would also identify the Part 32 expense accounts that were associated with switching. Clearly, accounts such as 32.6210 (central office switching expense) and 32.121 (land and building) would be included in the LRIC cost of switching, while accounts such as 32.6231 (radio systems expense) and 32.6431 (aerial wire) just as clearly would not. General overhead expense accounts, such as 32.6710 (executive and planning) and 32.6720 (general and administrative) would be included, since they support all services. Using the investment as an allocator, the incumbent LEC could assign a reasonable proportion of those expense accounts to

the facilities that were being provided. These costs would form the starting point for negotiations, and they would provide data that the States or the Commission could use in arbitrating an agreement.

This methodology has already been used for similar purposes. When AT&T divided up the assets of the old Bell system between itself and the divested BOCs in 1983, certain facilities and functions had to be shared for an interim period. These facilities included inter-office trunks, switching systems, systems for operator services, land and buildings, towers, and a wide variety of other facilities.[111] AT&T drafted the Shared Network Facilities Agreements ("SNFAs") to establish the charges that each party would assess to the other for shared facilities. As its name indicates, SNFA provided leases of facilities, rather than jurisdictionally distinct telecommunications services. Moreover, SNFA charges were based on a Costing Manual that used the Part 32 system of accounts to identify the investment-related costs, direct costs, and overhead costs for each facility.[112] The costs and revenues for SNFA contracts were removed prior to separations from the LECs' books. While the Commission would probably not use the SNFA costing methodology for interconnection, the experience with SNFA contracts shows that the costs of particular facilities can be derived from the Part 32 books and that prices can be developed without reference to access rates or other rate-of-return pricing methodologies.

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[111] See In the Matter of Investigation of Special Access Tariffs of Local Exchange Carriers, 8 FCC Rcd 1059 (1993) at ¶ 23 n.18.

[112] See id. at ¶ 91.

2. The Commission Should Not Adopt Proxy Factors Such As The Benchmark Cost Model Or Existing Access Rate Elements

The Commission asks for comments on using proxy factors to set outer bounds on the reasonableness of rates for interconnection.[113] The proxy factors described in the NPRM are definitely inappropriate, as they would reflect neither the LRIC nor any other reasonable measure of a LEC's cost. For instance, the Benchmark Cost Model ("BCM") [114] that NYNEX and other parties submitted in the Docket 80-286 Universal Service Fund investigation has no utility for setting rates for services or facilities. That model was designed simply to target high-cost subsidy payments to Census Block Groups where loop costs were relatively higher than in other areas. It is based on a limited set of assumptions about the costs that affect the costs of loops, such as distance, population density, and soil conditions. It does not reflect the costs of installing plant in urban areas, since it assume that a carrier can simply dig a trench along a road to lay cable. It does not include the investment in the drop wire and the network interface, and it does not include riser cable. Also, for urban areas with loop lengths over 12,000 feet, it assumes analog copper feeder plant. However, in urban areas, due to space restrictions in cable vaults and conduits, LECs usually use fiber facilities.

The BCM is not designed to estimate the costs of serving business customers, it assumes one type of central office switch, and it uses ARMIS cost loading factors that assume that costs are spread over the existing, larger investment base. When the ARMIS factors are applied to the smaller investment base in the BCM, they do not reflect the actual costs that would

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[113] See NPRM at ¶¶ 134-143.

[114] See NPRM at ¶ 137.

be incurred even if the facilities identified by the model were used to provide service. Moreover, MCI's use of a limited number of loading factors to support its "incremental" cost analysis further exacerbates the inaccuracies of this model. Since the model was never designed to represent the actual cost of service, it has no utility as a benchmark for reasonable interconnection rates.

Due to these limitations, the BCM falls far short of determining a LEC's network costs. An entirely new model would have to be developed to include all relevant cost factors for both urban and rural areas, and for residence and business customers.

Similarly, it would be unreasonable to use a "subset" of the LECs' existing access charges to set bounds on the rates for interconnection.[115] First, there is no correlation between the rates for jurisdictionally separated services and the costs of facilities or equipment at the total company level. Interstate access services are the product of Part 36 cost allocation rules and Part 69 access charge rules that combine costs and investments into broad categories. The rules then allocate those costs and investments between state and interstate, and among interstate access categories, based on arbitrary allocation factors that have little to do with how the costs and investments are used for each service. Second, the rate structure for access services, where the LECs spread the costs of shared facilities among all customers, is not appropriate for facilities or equipment that are dedicated to the use of an interconnector. An interconnector may need only a small part of the functionality that is included in an access service. In addition, using access rates as a proxy might not ensure that a CLEC paid rates that would cover the costs of the

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[115] See NPRM at ¶ 139.

facilities that were dedicated to its use. Third, a subset of existing rates guarantees that the LECs will not recover their total costs and that access customers would seek to undercut the existing interstate revenue stream by purchasing access through interconnection agreements. For instance, if the Commission used the LECs' interstate switched access usage rates, minus the transport interconnection charge ("TIC") and the CCL, as a proxy for local switching costs, an IC that qualified as a CLEC could purchase local switching services as unbundled network elements at roughly half the price that the LECs currently charge for switched access services. As noted above, this would contradict the statutory guarantee that the LECs would have an opportunity to recover their costs, plus reasonable profit. It would simply encourage efforts by access customers to evade the access charge system, and it would discourage, rather than encourage, competition in the local exchange, because ICs would not need the services of CLECs to obtain the lower rates. Access charges, alone, cannot be used as a proxy for the costs of interconnection.

The Commission questions whether it should derive the ceiling prices for unbundled loops from the existing interstate common line charges.[116] As the Commission notes, the existing interstate common line category recovers only 25% of the LECs' unseparated loop costs. In addition, the state and interstate rates associated with common lines are applied in

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[116] See NPRM at para. 141. The Commission asks for comments on whether it should adopt a ceiling price for unbundled loops based on (1) the subscriber line charge ("SLC"); (2) a flat-rated carrier common line charge ("CCLC"); and (3) a subset of the state local exchange rates.

different ways to different categories and classes of customers.[117] This would make it difficult to use such rates as a proxy for the costs of an unbundled loop.

E. The Commission Should Not Adopt An Imputation Rule For Pricing Of Unbundled Elements

Finally, the Commission seeks comment on whether it should adopt a rule (the "imputation rule") that would require that the sum of the rates for unbundled network elements be no greater than the retail service rate.[118] There is no provision in the Act for the application of any ceiling -- through use of imputation rule or otherwise -- on the charges for unbundled network elements. Furthermore, since some retail rates are below cost (for example, local residential service), an imputation rule would force LECs to sell unbundled elements at well below cost, which would be confiscatory.

In addition to these legal infirmities, a ceiling preventing an incumbent LEC from recovering its costs does not make economic sense. It would discourage incumbent LECs from investing in network improvements by increasing the risk that costs would not be recovered. In addition, by artificially setting prices too low, it would encourage competitors to under-invest in their own facilities, thereby impeding the development of facilities-based competition in the local market.

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[117] There are different caps on the SLC for residence and business customers, and state local exchange rates vary by the type of package (measured or non-measured rate) and the class of customer (residential, business, Centrex, etc.). In addition, certain state rates, such as residential exchange rates, are specifically set to recover less than the state portion of common line costs.

[118] NPRM, ¶¶ 184-187.

Finally, restrictions on cost recovery are fundamentally inconsistent with the intent of Congress as stated in the NPRM: "[T]he Act expressly confirms that incumbent LECs may earn a reasonable profit for the ... network elements they provide."[119] The Commission's rules should therefore permit incumbent LECs to charge rates that are cost-based and include a reasonable profit for the provision of network elements without application of an imputation rule or other rate ceiling.

VIII. THE COMMISSION SHOULD ONLY REQUIRE LECs TO PROVIDE A MINIMUM SET OF UNBUNDLED ELEMENTS.

The NPRM seeks comment on access to unbundled network elements offered by incumbent LECs. The Commission tentatively concludes that it should identify a minimum set of network elements that incumbent LECs must unbundle: loops, switches, transport facilities, and signaling and databases.[120] In addition, the Commission tentatively concludes that it should require further unbundling of the local loop.[121]

NYNEX believes that the Commission's focus should be on identifying those elements, interconnection points and functions that are most important to facilitate the advancement of local competition in the near term as opposed to conceptual discussions of what every potential element, point or function might be. As with most rules and regulations, experience in the marketplace is the only way to find out what makes sense from a customer service and operational perspective. The sooner the industry begins operating in the new mode,

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[119] NPRM ¶ 11 (citing § 252(d)(1)).

[120] NPRM, ¶ 77.

[121] NPRM, ¶ 97.

the faster the real needs will become apparent and the faster the real customers of the industry will experience the benefits.

In addition to establishing a minimum set of unbundled elements that will meet the bulk of the interconnectors' requirements and allow competition to continue to evolve at the local level in the most efficient manner, the Commission should also establish a well-defined process for identifying, negotiating and satisfying additional needs on an individual interconnector and situation basis. This will allow NYNEX and other incumbent LECs to meet specific interconnector needs without causing mass disruption in existing systems and processes.

NYNEX agrees that the Commission should only require unbundling of a minimum set of network elements.[122] Unbundling of any additional network elements should be the subject of carrier negotiations. NYNEX recommends that this set consist of the following network elements:

(a) Loop – The Loop from the customer premises to the incumbent LEC's serving wire center.[123]

(b) Switching – End office switching[124]

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[122] Network elements should not be defined in terms of specific, physical pieces of network hardware, but rather in terms of functionality. For example, a loop should not be defined as a pair of copper wires, but rather as a 300-3000 Hz transmission path, not to exceed 1300 ohms. The functionality, in this case, may be provided over a pair of copper wires, over an analog loop carrier system or over an optical digital loop carrier system. The service and functional characteristics are the same. However, over time, the physical path may be changed due to network modernization or rehabilitation requirements.

[123] The loop provides a basic transmission path from the customer's network interface to a point in the serving central office as determined by the incumbent LEC. The loop provides the functionality equivalent to a two-wire copper loop with a bandwidth from 300 Hz to 3000 Hz at 1300 ohms using technology of the incumbent LEC's choice.

[124] This option provides for the establishment of a temporary transmission path to connect one port on a local end office switch to another port on the same switch. Typical functions

– Tandem switching[125]

(c) Transport – Dedicated Transport[126]
– Common Transport[127]

(d) Signaling – Signaling Link[128]
– Signaling Transfer Point (STP) Port[129]

The Commission, however, should not require further unbundling of the local loop or other parts of the network. Requiring incumbent LECs to unbundle a multitude of network elements is not necessary to further advance competition in the local market. Additional unbundling requirements over that specifically required by the Act will only serve to impose unnecessary obligations on incumbent LECs, slow down competition in the local exchange market, and delay BOC entry into the long-distance market, a result not intended by Congress. Furthermore,

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include the recognition of service requests, call supervision, the provision of dial tone or start signals, digit reception and interpretation, ringing, and message recording.

[125] This option provides for the establishment of a temporary transmission path to connect one port on a tandem switching office to another port on the same switch for the purpose of completing interswitch calls. Typical functions include call supervision, digit reception and digit interpretation.

[126] This option provides an interoffice transmission path from the incumbent LEC switch (end office or tandem) to the interconnector's switch or point of presence. These paths are dedicated entirely to carry traffic of, and for the full-time use of, a specific carrier.

[127] This option provides an interoffice transmission path from the incumbent LEC end office to another end office or a tandem switch which may carry the traffic of several carriers as well as incumbent LEC traffic.

[128] This option provides a digital transmission path which supports a 56 Kbs signaling interface between a Signaling Transfer Point (STP) and a carrier's STP or switch for the purposes of exchanging SS7, out-of-band signaling messages.

[129] This option provides for the physical connection which terminates a signaling link on a Signaling Transfer Point. It is the point from which all agreed to signaling functions within the STP and the subtending signaling network can be accessed.

detailed unbundling requirements minimize the potential for meaningful State input in shaping the evolution of competition under the Act.

Another key principle that the Commission must recognize is that LECs should not be obligated to deploy new facilities or equipment in their networks in order to provide a new network feature or capability as an unbundled element to a requesting carrier. NYNEX agrees that to the extent LECs deploy new network facilities, equipment, features and functionalities in order to satisfy their general common carrier obligations, such facilities and features will be made available to other carriers on a non-discriminatory basis. However, if a LEC does not currently provide a feature that a requesting carrier wants, the Act's unbundling requirements do not obligate the LEC to make the investment necessary to provide that new feature to the carrier.

NYNEX recognizes and agrees that unbundling is an effective way to foster fair and reasonable competition in the local exchange network. However, the Commission must recognize that the local exchange network, which has been built up over the past 100+ years, was designed to be a reliable integrated network, provisioned and operated by a single network provider, and maintained through a cohesive set of systems, standards, policies and procedures. Changing this paradigm simply cannot be accomplished overnight.

A. Technical Feasibility

Under Section 251(c)(2)(B), an incumbent LEC must provide interconnection and access to unbundled network elements at "any technically feasible point" within its network. The NPRM identifies potential technically feasible points of interconnection as the trunk and loop-side of the local switch, transport facilities, tandem facilities and signaling transfer

points.[130] The Commission seeks comment on whether it should specify additional points of interconnection at this time.[131]

Technical feasibility implies that the point of interconnection is operationally manageable, defined by an open interface specification, and meets the service and security needs of the interconnectors, the LEC and their customers. NYNEX agrees that it is technically feasible to provide interconnection at the above-mentioned points identified in the NPRM. However, other possible interconnection points should be left to negotiations between carriers. NYNEX disagrees with the Commission's tentative conclusion that interconnection at a particular point in the network will be considered technically feasible if the incumbent LEC currently provides, or has provided in the past, interconnection to any carrier at that point, or if other LECs with similar network technology provide interconnection. Such a standard is inconsistent with the LEC's need to deploy new technology and fails to take into account differences in LEC operational systems and the differing technologies deployed. For example, two incumbent LECs with the same switch generic may not use the same specific features provided by the generic or may not offer the same features in the same operational manner.

NYNEX does not believe that it is productive to engage in arguments about the "technical feasibility" of particular unbundled elements, interconnection points or access to network functionality. Presuming that no one will ask us to change the laws of physics, any conceivable element or interconnection point can be created given enough time and resources.

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[130] NPRM at ¶ 57.

[131] NPRM, ¶ 116.

The real issues are the quality of the service provided, the operational practicality and the pragmatic ability to administer the arrangement in a real, competitive business environment. Those who want to delay and obstruct the implementation of the Act will focus on technical arguments. Those who share NYNEX's commitment to expediting implementation will focus on how to provide capabilities now.

While there are certain points in the network where interconnection can be provided quickly and supported with minimal additional operations support systems functionality, other places that appear on the surface to be interconnection points (i.e., feeder/ distribution cabinets or local distribution Service Access Interfaces) are actually logistical management points where large cables and facilities are divided and branched for distribution to smaller areas. These points were designed to be used during the plant construction process and not to support on demand access to service. They are also sized and engineered for a precise dedication of capacity between the larger and smaller facilities. While interconnection at these other points is theoretically possible, each situation must be looked at in light of operational concerns, accessibility, security, reliability, etc. What might be possible in one location may not be available in another due to a mix of hardware, vintages of equipment, available space, etc. What is theoretically possible in connection with sub-loop unbundling should not be confused with technical feasibility.

B. Collocation

The Act requires an incumbent LEC to provide for the collocation of equipment necessary for interconnection or access to unbundled network elements to enable the interconnector to provide local exchange and exchange access service. NYNEX believes that the

Commission should utilize the same rules that it currently has adopted for Expanded Interconnection.[132] Thus, collocation should only be required at central offices for the type of equipment that the Commission previously allowed in the Expanded Interconnection proceeding.[133] Collocation at locations other than the central office should be negotiated on an individual basis.

There is also no basis in the Act to require incumbent LECs that provide physical collocation to also offer virtual collocation. Virtual collocation should be provided only if it is mutually agreed to by the parties, or if the LEC cannot provide physical collocation as a result of space limitations. The Commission should not require virtual collocation when physical collocation is offered.

C. Sub-Loop Unbundling Should Not Be Required

The Commission seeks comment on whether it should require sub-loop unbundling. At this time, it is clear that further unbundling of the local loop is not technically feasible in the short term. As stated above, the existing network, including the loop plant, was not designed to accommodate multiple network providers. A fundamental redesign of interconnecting points would be required in order to accommodate multiple requests for interconnection at additional points in the loop. Such a universal redesign of the network should

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[132] NYNEX agrees with the Commission's tentative conclusion that the existing rules governing Expanded Interconnection should continue to apply. There is nothing in the Act that requires the Commission to revisit and/or revise these policies.

[133] Although not specifically mentioned in the Act, it would be reasonable to assume that Congress intended that the pricing principles that apply to network elements and interconnection facilities would apply to collocation facilities, i.e., cost plus a reasonable profit.